



CLIENT ACTION Bulletin

Employee Benefits

Guidance Issued on In-Plan Roth Rollovers to Designated Roth Accounts

SUMMARY The IRS has issued *Notice 2013-74*, providing guidance on the expanded types of amounts eligible for in-plan Roth rollovers within 401(k), 403(b), or 457(b) governmental retirement plans. These amounts, which became eligible for in-plan Roth rollover treatment in 2013 under the 2012 American Taxpayer Relief Act, include sums that are otherwise not distributable to participants under the terms of the plan, such as elective deferrals, matching contributions and nonelective contributions, and annual deferrals made to 457(b) governmental plans. The IRS's new guidance also includes deadlines for adopting plan amendments to provide for these in-plan Roth rollovers of such otherwise nondistributable amounts, as well as rules applicable to all in-plan Roth rollovers.

DISCUSSION **Background**

A 2010 law allowed 401(k), 403(b), and governmental 457(b) plans that permitted designated Roth elective deferrals to be amended to permit participants (or their surviving spouses) to convert their vested pre-tax accounts to after-tax Roth accounts within the same plan without taking a distribution from the plan. The amounts eligible for conversions had to be distributable from the plan according to the plan's terms. An in-plan Roth rollover is treated as a taxable distribution in the year it occurs, and the participant must pay income tax on the amount converted. These converted amounts and related earnings generally are not subject to income tax when ultimately distributed from the plan. The law's restriction – permitting only distributable amounts for conversions – effectively limited conversions to participants aged 59-1/2 or older who were eligible for an in-service withdrawal or those who had a severance from service.

Effective Jan. 1, 2013, the 2012 American Taxpayer Relief Act expanded in-plan Roth rollovers to all vested pre-tax amounts held in such plans, even if such amounts are not otherwise distributable from the plan. Most plan sponsors, however, were hesitant to add this new provision to their retirement plans without IRS guidance.

Rules Applicable to In-Plan Roth Rollovers of Amounts Not Otherwise Distributable

IRS *Notice 2013-74*, released Dec. 11, 2013, provides that a plan that permits participants to make Roth elective deferral contributions can permit an in-plan Roth rollover of any vested amount. The guidance also provides that in-plan Roth rollovers of otherwise nondistributable amounts (and applicable earnings) remain subject to the same distribution restrictions applicable to the amount before the in-plan Roth rollover. For example, if a participant who has not had a severance from employment makes an in-plan Roth rollover from a pre-tax elective deferral account prior to attaining age 59-1/2, that rollover amount (and applicable earnings) may not be distributed from the plan prior to age 59-1/2 or the occurrence of another event that permits a pre-tax deferral account to be distributed.

The Notice clarifies that an in-plan Roth rollover of an otherwise nondistributable amount is treated as an eligible rollover distribution, and because an in-plan Roth rollover of an otherwise nondistributable amount must be made by a direct rollover, no withholding applies. In addition, because this amount is not distributable (other than for purposes of making an in-plan Roth rollover), no part may be used for voluntarily withheld taxes. The IRS cautions that participants should be aware that they will be required to pay income tax on the full amount transferred and may need to increase their tax withholding from sources outside of the plan or make estimated tax payments to avoid an underpayment penalty.

Plan Amendments

The Notice provides guidance on plan amendments, including an extended deadline to add a provision to allow in-plan Roth rollovers in 2013 of otherwise nondistributable amounts. The extended

amendment deadline also applies to related amendments to add a provision to permit Roth elective deferral contributions and in-plan Roth rollovers of some or all otherwise distributable amounts if a plan did not already include such provisions. The effective date of the amendment must be the date the plan first allows the designated Roth account transactions permitted by the amendment. Other guidance relating to plan amendments includes:

- **401(k) plans generally** – In general, a plan amendment that provides for in-plan Roth rollovers of otherwise nondistributable amounts must be adopted by the last day of the plan year in which the amendment is first effective. However, for 401(k) plans that wish to add this new provision, an extended amendment deadline applies: the later of the last day of the plan year in which the amendment is first effective, or Dec. 31, 2014. Thus, a plan sponsor of a calendar-year 401(k) plan that began permitting in-plan Roth rollovers of otherwise nondistributable amounts during 2013 has until Dec. 31, 2014, to adopt such an amendment.
- **401(k) safe harbor plans** – By regulations, sponsors of 401(k) safe harbor plans are prohibited from making mid-year changes to plan provisions, except under specific circumstances. The Notice provides a temporary period through Dec. 31, 2014, for plan sponsors to make a mid-year change to provide for in-plan Roth rollovers of otherwise nondistributable amounts. Thus, a calendar-year 401(k) safe harbor plan sponsor that wishes to permit in-plan Roth rollovers of otherwise nondistributable amounts during 2013 or 2014 must adopt an amendment by Dec. 31, 2014.
- **403(b) plans** – Sponsors of 403(b) plans have an extended deadline to adopt a plan amendment to allow in-plan Roth rollovers of otherwise nondistributable amounts: the last day of the plan year in which the amendment is first effective or the end of the plan's remedial amendment period, whichever is later. The IRS has not set an end date for the remedial amendment period for most 403(b) plans complying with the 2007 final regulations, but says the deadline will not be before 2015.
- **Governmental 457(b) plans** – In the case of a governmental 457(b) plan, an amendment permitting in-plan Roth rollovers of otherwise nondistributable amounts during 2013 and 2014 must be adopted by the later of: the last day of the first plan year in which the amendment is effective, or Dec. 31, 2014.

Additional Guidance Applicable to All In-Plan Roth Rollovers

The IRS Notice also provides guidance on: limiting the type of contributions eligible for and the frequency of in-plan Roth rollovers; discontinuing in-plan Roth rollovers in an ongoing qualified Roth contribution program; the five-year holding period required for qualified distributions when an in-plan Roth rollover is the first contribution made to an employee's designated Roth account; accounting for in-plan Roth conversions in determining the present value of accrued benefits for top-heavy status; and distribution of excess deferrals, excess contributions, or excess aggregate contributions from a Roth account consisting of rolled over amounts from other accounts in the same plan.

ACTION

The IRS Notice offers 401(k), 403(b), and 457(b) governmental plan sponsors the needed guidance to move forward with in-plan Roth rollovers and conversions, features that some employees will find advantageous as they consider their retirement income needs. Plan sponsors that implemented in-plan Roth rollovers during 2013 or that intend to do so in 2014 should begin planning to make their plan amendments setting forth the rollover provisions by Dec. 31, 2014 (or, for 403(b) certain plan sponsors, anticipate a later amendment deadline). Appropriate communications materials should be prepared, and payroll and/or other administrative systems may have to be adjusted.

For additional information about the IRS Notice or for assistance with adopting in-plan Roth conversions or rollovers, please contact your Milliman consultant.